RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 • REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION
POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038
26 LETTERS PER YEAR • $225 ANNUALLY

August 24, 1983 LETTER 868

Aug. 12, DJIA 1182.83; PTI 1693; A-D Ratio –15.42
Aug. 19, DJIA 1194.21; PTI 1707; A-D Ratio –15.09

THE PICTURE: The overriding question about the market at any given time is–"Is the primary trend still in force?" Applied to today's market the question would be–"Is this still a primary bull market?" If the answer is "yes," then the investor has the single most valuable piece of information that he can possess. For if it's still a bull market, the great primary force of the market will be on the side of the stockholder. In that case, it is simply a matter of time before the Averages rise to new highs along with the great majority of stocks.

It is also well worth noting that bull markets don't act like bear markets. One major difference is that over-sold conditions in bull markets are not nearly as severe as over-sold situations during bear markets. In other words, you can't expect investors and traders to become as pessimistic during a bull market as they do during a bear market. Let me put it still another way–it takes a lot more pessimism and gloom to halt a bear market decline than it does a bull market correction.

Most of the advisory services and even most of the leading brokerage letters (such as the Hutton and the Merrill Lynch reports) now analyze the sentiment situation in detail. Thus, most of the mystery is taken out of statistics such as the margin account selling, odd lot short selling, advisory service sentiment, etc. But we have to operate on something in this business, and I prefer to be guided by the action of the market itself.

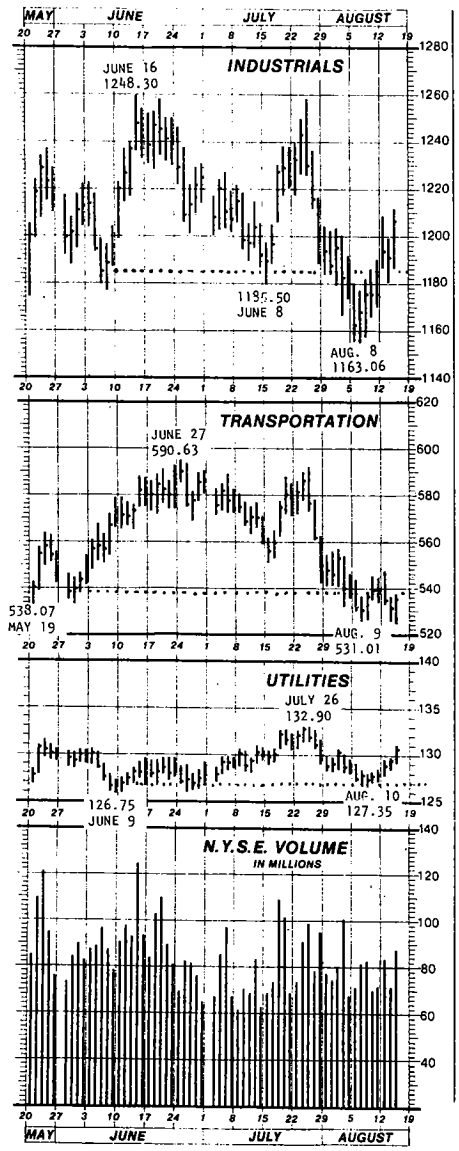
For instance, it's not difficult to see that sentiment is turning bearish when the broad S & P index is falling day after day. It's not difficult to smell the bear when the Dow goes down week after week. And it's hardly a sign of optimism with daily declines registering above 1000 in clusters of three and four consecutive days.

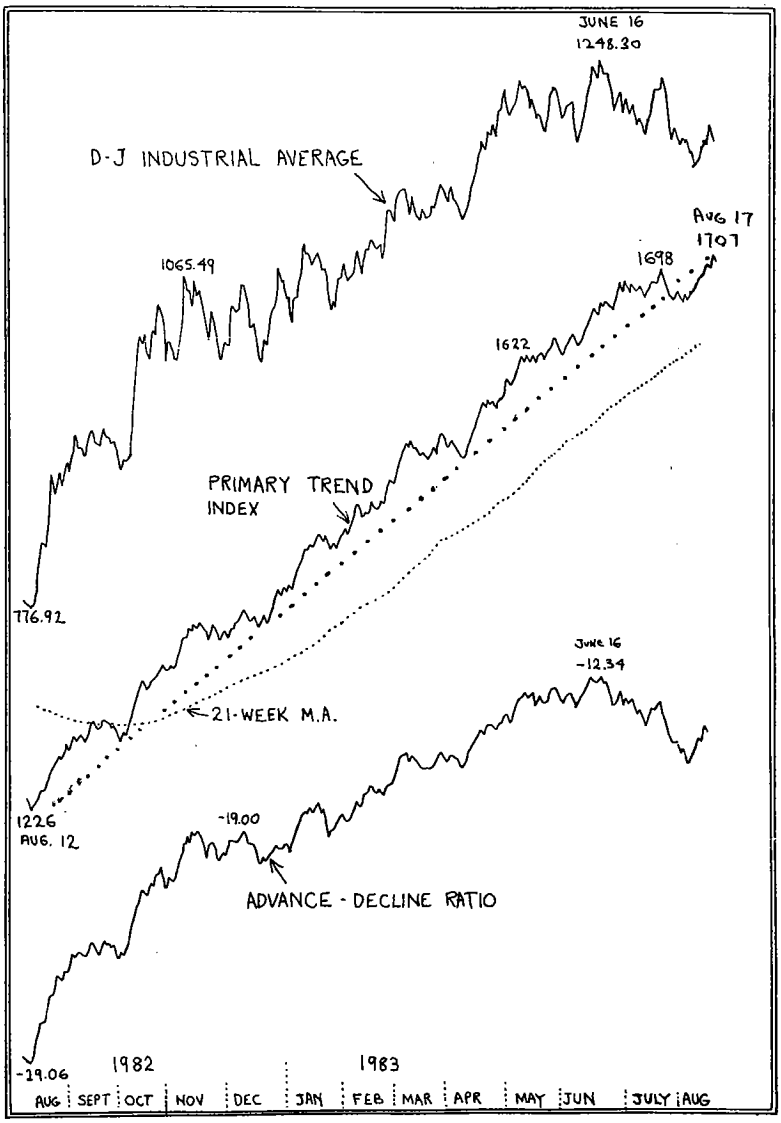
So in the light of this kind of thinking, what do I see in this market?

(1) As subscribers know, my PTI was extremely reluctant to go down during the May to August market weakness. The PTI recorded a high of 1698 on July 26, it hit a low of 1672 on August 2, and since then it has behaved rather spectacularly. On August 15, it even startled me–by rising to a new record high of 1699. Thus, despite a market that has exhibited varying degrees of weakness ever since last May, the PTI has refused to accommodate the bears.

Now I do know that the PTI is *capable* of falling apart. I know that the PTI can collapse. We saw the PTI collapse during July through November, 1971 and again during May, 1973 to December 1974. And during July, 1977 to March, 1978 the PTI literally fell apart. So the strange thing to me, as I study the picture, is that the PTI during the whole period of the market weakness since last May gave up a total of only 26 points! The PTI appears to be telling me that this market, despite all the groaning and hair-pulling and fear, is retaining a good deal of strength. My feeling is that this action is *characteristic of a primary bull market reaction.* The PTI seems to be saying that there is a technical strength in this market that simply will not be dissipated.

(2) Here is another item which must be taken into account. Historically, almost all primary bear market and bull market secondary reactions begin with DIVERGENCE between the Dow Industrials and the A-D ratio. The Dow and the A-D almost never hit a peak together, then simply turn down and collapse. I suppose that could happen, but I never like to bet on the unprecedented when it comes to Wall Street.





So we have a mystery here in that the Dow AND the A-D ratio both hit their peaks on June 16 and then turned down. If this is the beginning of a major slide, then we will have had a slide without any prior divergence between the Dow and the A-D ratio. It could occur–but it would be very, very unusual.

(3) Here's something else I'm watching. On a daily basis, despite weakness in the market since last May, the greatest number of daily new lows (NYSE) was only 20 recorded on August 9. That's hardly a sign of important weakness. In fact, considering that the advance-decline ratio turned down in mid-June, it's remarkable that a total of 20 lows was the most the bears could muster during three months of weakness!

(4) In recent Letters I emphasized the importance of the 1185.50 Industrial low of June 8 and the 538.07 Transport low of May 19. The 1185.50 low was broken on August 4 and the 538.07 low was cracked on August 10. Usually, when important lows are penetrated (and this is particularly true in a bear market) the market produces a waterfall on the downside. But there was NO FOLLOW–THROUGH on the August 4 and 10 downside penetrations. Occasionally, the market will test a low by breaking it–just to see if there is any overhanging stock to be liquidated. I felt it was impressive that no liquidation came in on a breaking of the important May-June lows (see page 1 chart).

(5) Almost every major market advisory has moved to caution, and many have switched to outright bearishness (I'm not including those services who have remained bearish throughout the entire rise). Thus, a good many investors and traders are now on the sidelines awaiting "lower prices" and a Dow in the "low 1100s." But bull markets hate to accomodate the bears. Thus, there is at least a reasonable chance that those who have sold out or cut back substantially have lost their position in this bull market.

(6) The mutual funds continue to receive cash in enormous amounts. Therefore, even though the funds have been a bit careful of late, their cash reserves have continued to build. This means that enormous amounts of money are owned by the funds, and this money can enter the market at any time. I consider this a plus for Wall Street, and a most unusual plus at that.

(7) The D-J Utility Average refused, on the recent weakness (see page 1 chart) to break below its June low of 126.75. This action is all the more impressive because all during July and most of August, interest rates were rising (and the Utilities are interest-sensitive). Utilities are now within striking distance of their 1983 high of 132.90. I would take a bettering of 132.90 by the Utility Averages as a very bullish omen for the entire stock market.

(8) Last week the British (Financial Times) stock average rose to a record high. Historically, the British market (which tends to be weaker than the American market because the British economy tends to be weaker) tops out BEFORE the US market. Thus, the recent new high by the British market is a plus for the US market.

In view of all these observations, WHAT MIGHT WE EXPECT? Well here's one possibility. The whole picture could deteriorate from here. For instance, the PTI could suddenly swoon, the A-D ratio could plunge, and the main mass of the market could simply go down the tubes. That could conceivably occur–but it just hasn't, at least so far.

The Dow could run up to new highs spurred by strength in the PTI. Then if the A-D ratio refused to move up, refused to confirm, the groundwork might be set for a more serious situation. In that case I might recommend moving to the sidelines, because then we would have a possible major divergence between the Dow (a new high above 1248.30) unconfirmed by the A-D ratio.

Here is another possibility, and it may be the most logical and also the *most constructive* possibility of all. The market could mill around this area for quite a while, maybe a month or so or even longer. During that period we could see a few downside non-confirmations, we could see numerous rallies and declines, and the whole affair would add up to a period of backing and filling–base building. After that the market could be ready to embark on another leg up in the continuing primary bull market.

Conclusion: This is a difficult juncture in the market. Obviously, they don't serve up the market for Richard Russell's benefit, and therefore I am presenting possibilities, rather than announcing the course the market "must" take. Nevertheless, I think what has happened so far is encouraging. For instance, I think that the stronger than expected PTI is very significant and I think the lack of divergence between the Dow and the A-D is significant.

Finally, it is worth noting that the A-D ratio since May 20 has been down for 10 out of 13 weeks. Thus, Wall Street has discounted a lot of bearish news, and the market should be moving towards over-sold.

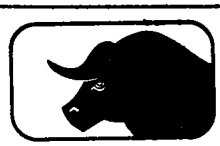
PRIMARY TREND INDEX: For the benefit of new subscribers, I should explain that the PTI is my proprietary index; it is made up of eight critical items, each calculated on a daily basis. These are all "action of the market" indicators as distinguished from "sentiment" indices . The resultant amalgum of these eight averages and indices provides me with a PTI figure each day. That figure is what you see pictured on the accompanying chart on page 2.

The PTI can lead the market or lag the market, but a PERSISTENT move by the PTI will always draw the market in the direction of the PTI, much like a magnet draws steel filings towards it.

When the PTI lags the market on the downside (as it recently did) I sometimes wonder. I wonder, "Is the PTI malfunctioning?" or "Is the PTI out of wack or has it stopped working?" But then I remember that most of my mistakes since 1970 have been made when I ignored the PTI or when I tried to out-smart my own indicator. So in the last Letter I emphasized that the PTI was very reluctant to follow this market down, and you can see that rather dramatically on the chart. The PTI seemed to be telling me something, and that something was "this market is retaining a lot of strength."

On August 17 the PTI rose to a record high of 1707, although this high was not confirmed by either the Dow or the A-D ratio (both of which are considerably weaker than the PTI). I don't think I have ever (in the last 11 years) seen the PTI so much stronger than the other indicators. This is a new situation for me, but my feeling is that as long as the PTI continues to record new highs, the stock market will be in a positive situation.

INVESTMENT POSITION: Anyone can sit with a full hand of stocks when the primary trend is bullish and the market is climbing. During a bull market correction (which is where we are now) it gets quite a bit harder to sit. But sit we will. I don't think the PTI would be hitting new highs if a bear market was in force, and this may be the single most important information we can possess. Sit with the defense stocks, the no-load funds and your T-bills. As a personal guess, I think the bond market has hit bottom, and I have bought long-term T-bonds for my pension fund. The bull remains in the box. His horns may be a bit blunted, but he's still there, and I suspect he's going to be there for quite a while.



At top right is the latest tabulation on the recommended defense stocks.

		Our Buy Price	Current Price	
NYSE	Harris Corp. (HRS)	49½	36 5/8	Defense stock average based on 1 share of each this week is 355
NYSE	LFE (LFE)	11 7/8	14½	
NYSE	Planning Research (PLN)	14 3/8	17½	
NYSE	Scientific Atlantic (SFA)	19	18 7/8	
NYSE	Tracor (TRR) 25% stock div.	28 3/4	30 5/8	
NYSE	Electronic Assoc. (EA)	13	13 5/8	
NYSE	Varo (VRO)	19	19½	
AMEX	Bolt Beranek (BBN) SPLIT 3 for 2	37	72 3/8	% Increase is: 27.7%
AMEX	BDM (BDM) SPLIT 2 for 1	43½	77½	
AMEX	Dynalectron (DYN)	12 3/4	14	
AMEX	Moog B (MOGB)	15½	19½	
AMEX	Systems Planning (SPZ)	7	11 5/8	
AMEX	American Science (ASE)	10½	9	
	Original purchase price 278			

CRYSTAL-BALLING IT: Every once in a while I lapse into what I call a "financial daydream. And here's my latest dream. But remember, this is just an exercise (on my part) in financial reverie. It may or may not happen this way.

Here we go: Everybody and his brother is complaining and whining about the "super-strong dollar." But I think the strong dollar is a good thing. The strong dollar amounts to a subsidy (i.e., a gift) to the rest of the Free World. The strong dollar means that literally everybody else's goods and services are cheap, a bargain, in terms of dollars. In other words, the US and its strong dollar are creating a bullish business climate for anyone outside the US who wants to sell goods to the biggest market in the world–the US.

Now, obviously, the strong dollar makes it hard for US exporters to sell their own goods to foreign sources. But I think that the US economy is strong enough to handle that.

One of the forces behind the strong dollar obviously is high interest rates. Everyone and his brother wants dollars because the real return on dollars is so attractive. But today's high interest rates have weighed heavily on the stock market. For instance, long-term Government bonds are now in the 12% yield area. At 12%, you can triple your money (if it's tax deferred in an IRA or a pension plan) in 9 to 10 years. That's heavy competition for stocks.

Next thought. I think there's a fair to good chance that gold could crack. I think gold could go down to 375 or even 350. If gold did that, I think the markets would take it as a sign of "no inflation in the foreseeable future." In that case, I think the bond market (which is now heavily over-sold) would take the no-inflation picture as bullish, and bonds would rally strongly.

If bonds rallied strongly, interest rates would suddenly come down. And if that happened, the stock market would love it. In which case, the market, which has been going sideways to down ever since last June, could take off on the upside.

So that's my "possible scenario", and I think it's an interesting one. On that basis, if my scenario has any truth in it, one would buy the long-term Treasury bonds for his IRA or pension plan at this time, and he would sit with his stocks. And oh yes, he should stop cursing "that blasted strong dollar!"

MONEY: The chart on page 5 pictures the T-bond contract, September '83. As I read bonds, they have made a five-wave move down. Then most recently the bonds rallied just above their declining trendline–before turning down again.

Personally, I believe the bonds have made a bottom and turned. Great action would be any move on the September contract to 74. From there, any decline could provide the outline for a

(continued on Page 5)

DEFENSE SECTION

Most or all of the defense information (but not stock information) is based on an exclusive arrangement with Mr. Melvyn Lippman of US Organization Chart Service, La Jolla, California.

I did not add this defense section lightly. Veteran subscribers know that I am very survival minded. Just as gold represented the "survival mechanism" of the 1970s, I believe that US military capabilities will represent the survival mechanism of the 1980s and '90s. But an understanding of the Russian-American military equation is crucial. So along those lines, I have included a section which I expect will be educational, useful and often shocking.

Russell questions Lippman: Mel, for many years following World War 11 the US was the undisputed world's dominant military power. What happened? What allowed the Russians to catch up to us?

Lippman: The answer lies in a word I call "perceptions." And really, our perceptions of the Russians. For instance, the US perception of how to run a country, how to run our military, how to run our economy, how to run our government, even how we view the world–all these perceptions are very different from those of the Russians. And it was our failure to understand how the Russians perceive these things that permitted the Russians to catch up to us militarily.

Let me explain further. From a military standpoint, the Russians perceive themselves as surrounded by hostile nations. They also perceive that their allies may be unreliable. Thus, the Soviets' concern about their "security" has been pervasive and extremely consistent. The Russians believe that a nation's power, prestige and even its economic stability bears a direct (in fact, an inseparable) relationship with its military capabilities. In other words, the Russians believe that the strongest country (the country with the strongest military) dictates to the rest of the world what they can do–and what they cannot do. In the Soviet view, the world military leader is the world leader.

This whole perception has allowed the Russians to build the greatest military-industrial complex in history. Furthermore, the Russian complex continues to grow rapidly. Stability and continuity characterizes the massive Russian military. It just "keeps rolling." The Russians concentrate on large military investment and the continuous acquisition of modern weapons. Russian military investment and weapons constitute a leading indicator of Russian capabilities. This is hardly an earth-shaking revelation, but what may surprise many Americans is that the Russians have been doing this for decades.

For instance, the Soviet RDT & E (research, development, test and evaluation) is currently DOUBLE that of the US (in amounts spent), and this trend is now TWENTY YEARS LONG! The US adds FEWER weapons each year. In contrast, the Russian output has been growing each year even though the complexity and sophistication of their weapons increases.

The Russians are deadly serious about their military. In the March, 1970 issue of the Soviet military magazine, "Modern Artillery," Soviety General A.N. Latuhkin writes: "It is quite correctly stated that the first generation of weapons is on the line, the second generation is on the proving grounds, the third is in the experimental shops, the fourth is on the drawing boards and the fifth is taking shape in the minds of the scientists and designers on the basis of tactical-technical requirements."

It's important to realize that there are two different perceptions at work, and it is these opposing perceptions that have allowed the Russians to catch up and then pass the US. The US and its military operate on the premise that total war is impossible. The US concentrates on the feasibility of limited wars–and the US plans for limited wars. In contrast, the Russians believe that war with the US will be very difficult to avoid, and their military emphasizes the need to fight and win that war under any conditions. This concept provides the BASIS for the "Soviet Grand Strategy".

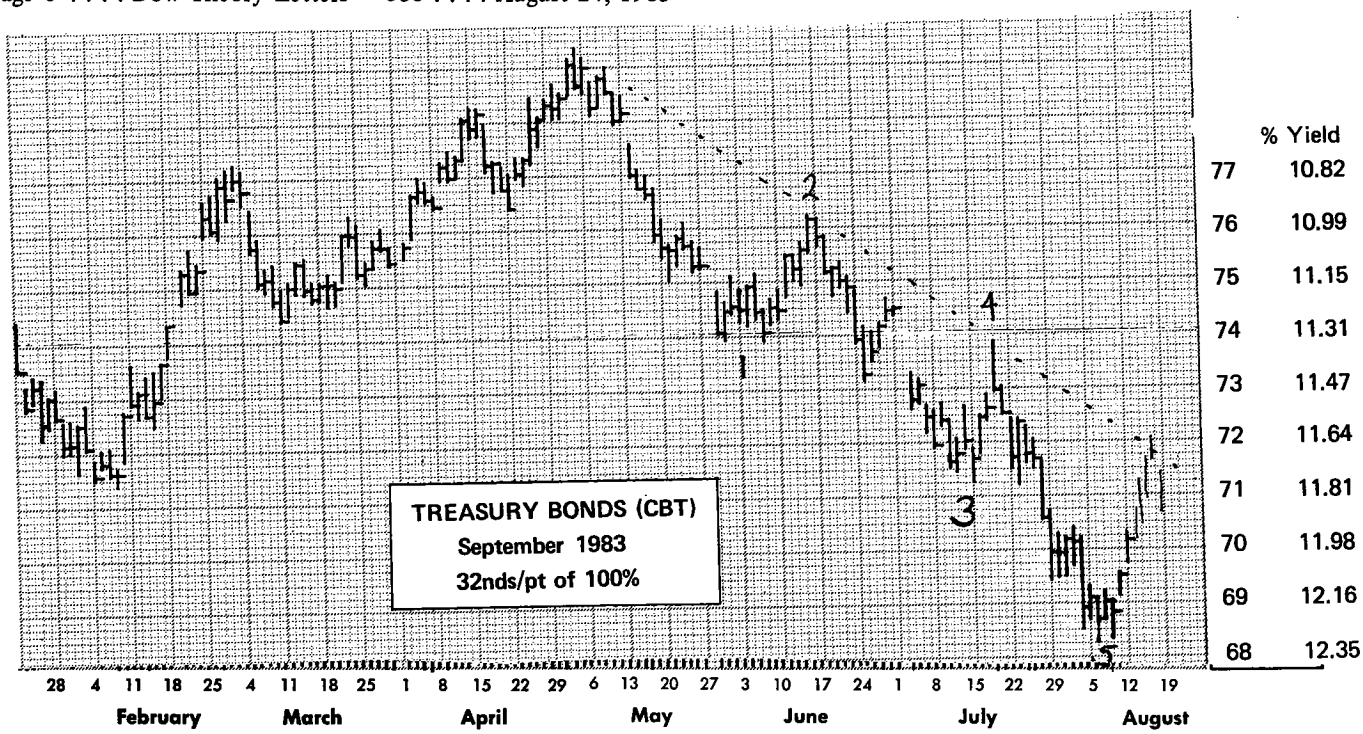
Turning to the US, it is difficult to find any overall strategy. The Russians act, the US responds. The US leaders are in a position where they must "read" the minds of foreign powers (especially military powers) and take appropriate steps to insure the survival of the US. But the Russian mentality is totally different from ours. And so far, our leaders have failed to read or understand Russian mentality.

So the question now is, "Are the Russians coming?" If the Russians feel that they are out-distancing us and that we are no military threat, then the answer is, "no the Russians are not coming." But if the Russians believe they are vulnerable to US military force, then the answer is, "Yes, there will probably be trouble with the Russians.

In summing up, I would put it this way: "The Russians have been playing a deadly serious and complex game of chess. And the US, unfortunately, has been playing checkers."

Coming in the next issue: Comments and reviews of the US's future major weapons systems, the B-1 Bomber, the Abrams M-1 Battle Tank and the MX Missile System. This installment is going to be controversial–and an eye-opener!

For new subscribers, I want to give a bit of background. I've known Melvyn Lippman for 22 years. I consider him brilliant and one of the best informed people on the world military situation that I have seen or that I know of. Lippman has been intimately connected with the gathering, appraisal and publishing of military and corporate information for a quarter of a century. What you read here and what you will be reading in this section will be information of the highest order, much of it information that you will see nowhere else. I consider the Defense Section a really fortunate addition to Dow Theory Letters.



head-and-shoulders bottom. A move by the bonds to 74 would be super-bullish for the stock market. The reason is obvious–if the bonds go up, interest rates come down. So watch these bonds closely, your broker can give you minute by minute quotes. (Chart courtesy of Dunn & Hargitt, 22 N. 2nd St., Lafayette, Indiana 47902).

CREDIT AND MORALITY: As veteran readers of these reports know, I have never been an advocate of the excessive use of credit. To my mind, the ultimate result of all the hundreds of billions of dollars of credit which have been extended throughout the world will be–negation. It can never, it will never be paid off. But somebody has to suffer–who will it be? That's easy, the pain of payment or bankruptcy will be our gift to your sons and my sons (and our daughters).

And on top of that, the fruits of the great credit expansion have been with us for years. We call those fruits–inflation. Inflation makes some men rich, but it robs the great majority. And the trouble with inflation is that just when the world is least prepared, it turns into deflation. Now deflation following a long period of inflation always means one thing, and that thing is depression. So I'm not a fan of massive credit extension nor am I a fan of inflation.

I always thought this paragraph by Henry Emerson Fosdick was well worth reading and understanding. Because basically, what Fosdick writes here is about the morality of credit, the morality of having it now, and paying for it (maybe) later.

"This is a universe of moral law, no more to be outwitted than is physical law. Look at our world and see. When we choose evil, we get what we want and then pay for it afterwards; but when we choose good we have to pay for it first before we get it. The young man in college who chooses an idle, lazy life can have that at once; today he can start that; he will pay for it afterwards. But the young man who wants a degree with honors cannot get that today. He must pay for it before he gets it, in hard work and self-discipline.

If a man wants a life of sensual excess he can have that tonight, with all the wild thrill and mad sense of exhilaration that he seeks. He can seize his passionate desire at once, and pay for it, it may be, long afterward. But a man who wants a noble character that, like a well-rooted tree, holds its own against the storms of life and in the autumn bears fruit for his generation's help, cannot get that at once; he must pay for it first and then get it."

NOTES & QUOTES: *NEW ORLEANS:* With this report I have included a brochure about the big Tenth Anniversary New Orleans seminar. This is the first time I have ever included a brochure in a mailing, and obviously there must be reasons why. The reasons are as follows: (1) I spoke at the first New Orleans seminar and I have spoken at most of them since. (2) This Tenth Anniversary seminar should be very exciting; it should be a blockbuster. (3) I'll be speaking twice at the November seminar. (4) I really believe that my subscribers will enjoy the 1983 Anniversary meeting. The cast of speakers should tell you why. (5) New Orleans is a heck of a place to have a good time. Warning: diet for a week first–New Orleans is a serious eating town–nobody jogs down there–nobody, not even the New Orleans Saints.

* *

Are women more honest than men–or just smarter about staying out of prison? I'd have to say they are more honest. Why? Probably because women are more in touch with their emotions, and people who are in touch with their emotions are going to be saner than those who are not.

The criminal makes one basic mistake (forgetting the morality of criminality). And that mistake is that the criminal is pitting his lone ability against the far superior forces of society, which includes the police, the FBI and all the data, resources and manpower that they command. It's a totally uneven fight for the criminal–the odds are stacked heavily against him.

Anyway, the statistics are interesting. Men outnumber women in prison 22 to 1. There are now a record of 425,000 in the nation's prisons and 18.5 thousand women. Texas leads the nation with 37 thousand inmates, New York is second with 28,000, California is tied with Florida at 26,000. The Federal system holds 31,000.

* *

Jerry Buss is a multimillionaire Californian who owns the LA Lakers, the NHL Kings and the LA Forum. Buss made his millions in real estate, but he seems well informed on a subject that I have pounded into the heads of my subscribers. The subject I am referring to is the "magic" of compound interest. Said Buss recently, when asked about the road to riches: "Get a part-time job on Saturday and do it for 10 years. Then take your money and invest it at 12% and wait 10 years more, and you're a millionaire."

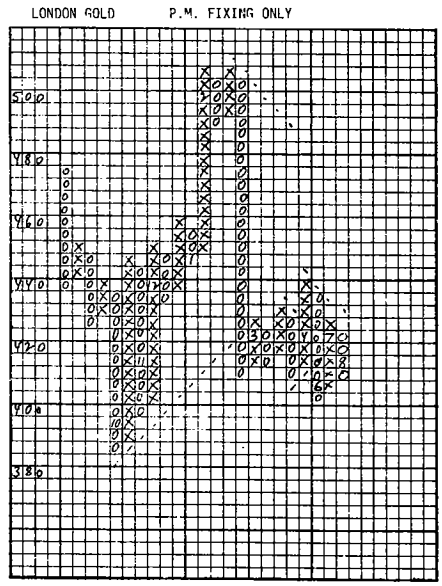
All of which reminds me, we're now in the era of big deficits and debts and HIGH interest rates. Long-term Government bonds now yield around 12%. At 12% your money doubles in less than 7 years, it triples at less than 10 years, and it quadruples at less than 13 years (all assuming that you can reinvest the proceeds on a tax-deferred basis at around 12%).

For those of you with pension plans or IRAs, these 12% long-term Government bonds are a good buy. If the bonds go down you can reinvest at higher yields (since lower bond prices mean higher returns), whereas if the bonds go up you will have appreciation in your account even though reinvestment yields will be lower. Put it this way: at 12% you'll be getting back 40% of your money in three years! At that rate, I don't give a damn whether the bonds go up or down (let 'em go down, I'll simply reinvest the money at higher rates).

In Hollywood they say that "There's no business like show business." Well, in the world of finance, there's no investing like high-interest compound investing, particularly if your returns are tax-deferred. It's THE *sure* road to riches, and any of my subscribers who are not playing this game are missing the ONLY SURE THING there is as far as making money is concerned.

GOLD: Nobody believes me, but I continue to feel that the basic world situation is deflationary. I base that on my thesis that the spiraling level of world debt has gone beyond the point where it can be easily serviced. Money is now being created simply to service debt. And in order to move to an inflationary environment more and more money will have to be created (it's like running up the down escalator–if you halt for a minute to catch your breath you end up on the ground floor!).

I include a chart showing the London second fixing (courtesy Chartcraft, Larchmont, NY). Gold is in a consolidation pattern, and the bright boys of the world are trying to figure whether the fomation represents accumulation or distribution. My own feeling is that it represents frustration, and that I have no clear feeling or intuition as to whether gold is going to break upside (above 445 to give a bull signal) or downside (to 400 to provide a bear signal). Since the market (any market) loves to drive traders and investors up the proverbial wall, gold could simply "sit" here for a while, or maybe for many months.



For over a year I've held that gold would not be a profitable investment. I continue to take this stand, and IF, IF gold hits 445 on the upside I'll reverse my stand and suggest positions in the metal.

LATE NOTES: A bull market has a number of ways of parting the stockholder from his wares. A bull market can (1) scare you out–via a sharp reaction or a series of scary declines. (2) wear you out by doing literally nothing for weeks or months on end.

It's well to remember that roughly 75% of the time in both bull and bear markets there is very little action. In other words, if you study the history of the Averages you will find that over the majority of trading days the market is marking time. The real action comes sporadically, and it's usually over fairly fast. Thus, Wall Street plays the waiting game, and the market knows that the average stockholder hates waiting.

We're playing the waiting game now, but there are a few very significant developments. On Friday, August 19, the PTI closed at the record high of 1707. On the same day my cumulative total of the most-active stocks (based on the plurality of those stocks that advance or decline each day) rose to a new bull market high. Now in my experience, following three months of corrective action (which we have had) you do not see new highs in the PTI and the cumulative most-active index–UNLESS YOU ARE IN A PRIMARY BULL MARKET!

Let me put it another way. If this was a bear market, we would place the beginning of the bear market at June 16, when the Dow and the A-D hit their 1983 highs. And if it was a bear market we would be seeing major deterioration after three months–rather than new highs in two important indicators.

Conclusion: From the evidence I see, my conclusion is that *the primary bull market is still in force.* The implications of this were explained on page 1 of this Letter. Sit tight. It's going to be all right.

NEXT MAILING: Sept. 7